

City of Waterbury, Connecticut

Investment Policy *November 2002*



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CITY OF WATERBURY

Investment Policy

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I. Background

According to Sections 1371-74 and Section 1572 of the City of Waterbury Municipal Charter (the "Charter"), the City's Board of Finance and Treasurer have the authority to oversee investment of all City funds with the exception of the assets of the Pension Trust Fund. In practice, responsibility for oversight and day-to-day management has been delegated to the City's Finance Director whose responsibilities include complying with applicable State statutes and protecting the public interest in safeguarding City funds. The purpose of this document is to specify the policies and guidelines that provide for the prudent and productive investment of funds.

The Charter states that the City may utilize "institutions whose duty it shall be to obtain the highest rate consistent with such [public] deposits". With the exception of assets in the Pension Trust Fund, all investments of City funds will be administered in accordance with this policy; the provisions of Connecticut General Statutes ("CGS") Sections 7-400-402, 3-24f, 3-27f and other applicable State statutes. The assets of the Pension Trust Fund will be administered under a separate policy.

II. Scope

This policy applies to the investment of short-term operating funds as follows;

- *Governmental Funds* – including the general fund, special revenue funds, capital project funds, debt service fund, and certain permanent funds. The assets of the City's deposit to the Special Capital Reserve Fund (the "SCRF") in connection with Special Act 01-1, as amended by Special Act 01-2, of the State of Connecticut General Assembly are considered a restricted debt service fund investment for purposes of this policy;
- *Proprietary funds* – including the enterprise funds and internal service funds;
- *Fiduciary funds* – including investment trust funds, private purpose funds, and agency funds.

In order to manage cash in the most efficient manner, the City shall maintain a pooled cash fund. Except for cash in certain restricted and special funds, the City will consolidate cash balances from all funds to maximize investment earnings. Investment income will be allocated to the various funds based on their respective participation and in accordance with generally accepted accounting principles.

III. General Objectives

The primary objectives, in priority order, of investment activities shall be safety, liquidity, and yield:

A. Safety

Safety of principal is the foremost objective of the investment program. Investments shall be undertaken in a manner that seeks to ensure the preservation of capital in the overall portfolio. The objective will be to mitigate credit risk and interest rate risk.

1. Credit Risk

The City will minimize credit risk, the risk of loss due to the failure of the security issuer or backer, by:

- (i) Limiting investments to the safest types of securities;
- (ii) Investing in only those types of investments that are covered by the State of Connecticut Municipal Investment Act;
- (iii) Pre-qualifying the financial institutions with which the City will do business;
- (iv) Diversifying the investment portfolio so that potential losses on individual securities will be minimized.

2. Interest Rate Risk

The City will minimize the risk that the market value of securities in the portfolio will fall due to changes in general interest rates, by:

- (i) Structuring the investment portfolio so that securities mature to meet cash requirements for ongoing operations, thereby avoiding the need to sell securities on the open market prior to maturity;
- (ii) Investing operating funds primarily in shorter-term securities, money market mutual funds, or similar investment pools.

B. Liquidity

The investment portfolio shall remain sufficiently liquid to meet all operating requirements that may be reasonably anticipated. This is accomplished by structuring the portfolio so that securities mature concurrent with cash needs to meet anticipated demands (static liquidity). Furthermore, since all possible cash demands cannot be anticipated, the portfolio should consist largely of securities with

active secondary or resale markets (dynamic liquidity). A portion of the portfolio also may be placed in money market mutual funds or local government investment pools, such as the State Treasurer's Short-term Investment Fund (STIF), which offer same-day liquidity for short-term funds.

C. Yield

The investment portfolio shall be designed with the objective of attaining a market rate of return throughout budgetary and economic cycles, taking into account the investment risk constraints and liquidity needs. Return on investment is of secondary importance compared to the safety and liquidity objectives described above. The core of investments is limited to relatively low risk securities in anticipation of earning a fair return relative to the risk being assumed. Securities shall not be sold prior to maturity with the following exceptions:

- A security with declining credit may be sold early to minimize loss of principal;
- An exchange of securities which would improve the quality, yield, or target duration in the portfolio;
- Liquidity needs of the portfolio require that the security be sold.

IV. Standards of Care

A. Prudence

The standard of prudence to be used by investment officials shall be the "prudent person" standard and shall be applied in the context of managing an overall portfolio. The Finance Director acting in accordance with written procedures and this investment policy and exercising due diligence shall be relieved of personal responsibility for an individual security's credit risk or market price changes, provided deviations from expectations are reported in a timely fashion and the liquidity and the sale of securities are carried out in accordance with the terms of this policy.

Investments shall be made with judgment and care, under circumstances then prevailing, which persons of prudence, discretion and intelligence exercise in the management of their own affairs, not for speculation, but for investment, considering the probable safety of their capital as well as the probable income to be derived.

B. Ethics and Conflicts of Interest

Officers and employees involved in the investment process shall refrain from personal business activity that could conflict with the proper execution and management of the investment program, or that could impair their ability to make impartial decisions. Employees and investment officials shall disclose any material interests in financial institutions with which they conduct business. They shall further disclose any personal financial/investment positions that could be related to the performance of the investment portfolio. Employees and officers shall refrain from undertaking personal investment transactions with the same individual with which business is conducted on behalf of the City. In any event, employees and investment officials shall comply with any City conflict of interest policies in effect from time to time.

C. Delegation of Authority

Authority to manage the investment program is granted to the Finance Director by the Board of Finance and Treasurer based on their approval through resolution or otherwise of these investment policies. Responsibility for the operation of the investment program is hereby delegated to the Finance Director, who shall act in accordance with established written procedures and internal controls for the operation of the investment program consistent with this investment policy. Procedures should include references to: safekeeping, delivery vs. payment, investment accounting, repurchase agreements, wire transfer agreements, and collateral/depository agreements. No person may engage in an investment transaction except as provided under the terms of this policy and the procedures established by the Finance Director. The Finance Director shall be responsible for all transactions undertaken and shall establish a system of controls to regulate the activities of subordinate officials.

V. Safekeeping and Custody

A. Authorized Financial Dealers and Institutions

A list will be maintained of financial institutions authorized to provide investment services. In addition, a list also will be maintained of approved security broker/dealers selected by creditworthiness (e.g., a minimum capital requirement of \$10,000,000 and at least five years of operation). These may include "primary" dealers or regional dealers that qualify under Securities and Exchange Commission (SEC) Rule 15C3-1 (uniform net capital rule).

All financial institutions and broker/dealers who desire to become qualified for investment transactions must supply the following as appropriate:

- Audited financial statements;
- Proof of National Association of Securities Dealers (NASD) certification;
- Proof of state registration;

- Completed broker/dealer questionnaire;
- Certification of having read and understood and agreeing to comply with the City's investment policy.

An annual review of the financial condition and registration of qualified financial institutions and broker/dealers will be conducted by the Finance Director.

B. Internal Controls

The Finance Director is responsible for establishing and maintaining an internal control structure designed to ensure that the assets of the City are protected from loss, theft or misuse. The internal control structure shall be designed to provide reasonable assurance that these objectives are met. The concept of reasonable assurance recognizes that (1) the cost of a control should not exceed the benefits likely to be derived and (2) the valuation of costs and benefits requires estimates and judgments by management.

Accordingly, the Finance Director shall establish a process for an annual independent review by an external auditor to assure compliance with policies and procedures. The internal controls shall address the following points:

- Control of collusion;
- Separation of transaction authority from accounting and record keeping;
- Custodial safekeeping;
- Avoidance of physical delivery securities;
- Clear delegation of authority to subordinate staff members;
- Written confirmation of transactions for investments and wire transfers;
- Development of a wire transfer agreement with the lead bank and third-party custodian.

C. Delivery vs. Payment

All trades where applicable will be executed by delivery vs. payment (DVP) to ensure that securities are deposited in an eligible financial institution prior to the release of funds. Securities will be held by a third-party custodian as evidenced by safekeeping receipts.

VI. Suitable and Authorized Investments

A. General Provisions

In general, all investments must be made in securities authorized by CGS Sections 3-24f, 3-27f or 7-400 or in deposits authorized by CGS Sections 7-401 and 7-402 with only limited deviation as follows:

Under CGS Section 7-403a, if certain conditions are met, assets of an internal service fund can be invested more broadly. However, until such time as this policy is amended, the City's only additional investment option for the internal service funds, apart from those delineated herein, will be commercial paper that is rated in the two highest rating categories by any nationally recognized rating service or of any rating service recognized by the State Commissioner of Banking (rated not less than Aa3 by Moody's, AA- by Standard and Poor's, or AA- by Fitch).

Under CGS Section 7-403, funds deposited in a trust fund account are considered an investment trust fund, and can be invested by the City with a custodian account with a trust department of any qualified public depository under the provisions of Section 7-402. Under 7-403, the municipality may prescribe the method of supervision of the investment and reinvestment of such funds. However, until such time as this policy is amended, the City's additional investment option for trust funds, apart from those delineated herein, will be commercial paper that is rated in the two highest rating categories by any nationally recognized rating service or of any rating service recognized by the State Commissioner of Banking (rated not less than A-2 by Moody's, P-2 by Standard and Poor's, or F-2 by Fitch).

B. Investment Types

The following is a summary of investments permitted by this policy, which are more specifically set forth in VI E, below:

- U.S. government obligations, U.S. government agency obligations, and U.S. government instrumentality obligations, which have a liquid market with a readily determinable market value;
- Certificates of deposit and other evidences of deposit at financial institutions, bankers' acceptances, and commercial paper, rated in the highest tier (e.g., A-1, P-1, F-1, or D-1 or higher) by a nationally recognized rating agency, except as otherwise noted above;
- Repurchase agreements whose underlying purchased securities consist of the foregoing;
- Money market mutual funds regulated by the Securities and Exchange Commission and whose portfolios consist only of dollar-denominated securities; and

- Local government investment pools, either state-administered or through joint powers statutes and other intergovernmental agreement legislation.

C. Collateralization

Collateralization of all short-term investments shall be provided as required by the Connecticut General Statutes.

D. Repurchase Agreements

Repurchase agreements must be collateralized in accordance with the Statutes of the State of Connecticut

Investment in derivatives is prohibited.

E. Specific Investment Guidelines

- (1) The City may invest in the following securities or deposits:
 - (a) U.S. government securities, including U.S. Treasury notes, bills and bonds, and federal agency securities, including obligations of the FHMLC, FNMA, GNMA, FSLIC, the U.S. Postal Service, all federal home loan, federal land and federal intermediate credit banks, the Central Bank for Cooperatives, and the TVA ("U.S. government and agency securities").
 - (b) Obligations of any state of the United States or of any political subdivision, authority or *agency* of any state of the United States. At the time of investment these securities must be rated within one of the top two rating categories of any nationally recognized rating service or of any rating service recognized by the State Commissioner of Banking (rated not less than Aa3 by Moody's, AA- by Standard and Poor's, or AA- by Fitch).
 - (c) Obligations of the State of Connecticut, or any regional school district, town, city, borough or metropolitan district in the State. At the time of investment these obligations must be rated within one of the top three rating categories of any nationally recognized rating service or of any rating service recognized by the state commissioner of banking (e.g., a rating of not less than A3 by Moody's, A- by Standard And Poor's, or A- by Fitch).
 - (d) Indirect investments in U.S. government and agency securities, and repurchase agreement; fully collateralized by such securities, through the purchase of shares or other interests in a custodial arrangement, pool or no-load, open-end investment company or trust registered or exempt under the Investment Company Act of 1940, whose portfolio consists solely of such securities, repurchase agreements and cash. The custodial

arrangement, pool or investment company or trust must take delivery directly or through a custodian of all collateral, must be managed to maintain its shares at a constant net asset value, and investment company or trust shares must be purchased and redeemed through, or the custodian for the fund or pool must be, a Connecticut bank or a federally-chartered bank with its principal office in Connecticut, or an out-of-state bank having one or more branches in Connecticut.

- (e) The State Treasurer's Short-Term Investment Fund established pursuant to CGS Section 3-27a ("STIF").
- (f) The State Treasurer's Tax-Exempt Proceeds Fund established pursuant to CGS Section 3-24a ("TEPF").
- (g) Repurchase agreements fully-collateralized with U.S. government and agency securities held by a third-party custodian bank. All repurchase agreements shall be conducted through authorized dealers in accordance with Section V. Reverse repurchase agreements are not permitted under this short-term investment policy.
- (h) Certificates of deposit, demand deposits, time deposits, share accounts, term share accounts and share certificate accounts ("deposits") in a Connecticut bank or credit union, in a federally-chartered bank or credit union with its, principal office in Connecticut, or in an out-of-state bank having one or more branches in Connecticut, which depository is a "qualified public depository" as defined in CGS Section 36a-330, and is not prohibited by CGS Section 36a-33 from accepting public deposits due to an unsatisfactory community reinvestment performance evaluation. If aggregate deposits in any one depository exceed the Federal Deposit Insurance Corporation limit (\$100,000):
 - 1. the City must have an executed collateralization agreement with the depository that is in compliance with 12 U.S.C. Sec. 1923(e), as amended (Sec. 214(4) of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989), and
 - 2. the depository's -
 - a. long-term debt must be rated at least C by Thomson Bank Watch and A- by Standard & Poor's, A3 by Moody's or A- by Fitch, and its short-term debt must be rated at least TBW-1 by Thomson Bank Watch and A-1 by Standard & Poor's, P-1 by Moody's or F-1 by Fitch, or
 - b. the depository's total risk-based capital ratio must exceed ten percent (10%).

- (i) Deposits in an "out-of-state bank" as defined in CGS 36a-2, which is not a "qualified public depository", as defined in CGS 36a-330, provided that total aggregate deposits in any one depository shall not exceed the Federal Deposit Insurance Corporation limit (\$100,000).
 - (j) Investments in shares of investment companies or trusts with fluctuating net asset values, while permitted by CGS Section 7-400, are not permitted under this short-term investment policy. No investments may be made in "derivative" securities such as futures, swaps, options, interest-only or principal-only mortgage-backed securities, inverse floaters, CMT floaters, leveraged floaters, dual index floaters, COFI floaters, reverse repurchase agreements, and range floaters. These types of securities can experience high price volatility with changing market conditions, and their market values may not return to par even at the time of an interest rate adjustment. These restrictions apply to direct investments as well as to investments through custodial arrangements, pools or money market funds discussed in Sections VI E 1(d) to (f). Thus, if a custodial arrangement, pool or fund includes securities prohibited by this paragraph; the City may not invest in shares or other interest in such custodial arrangement, pool or fund.
 - (k) Investments may be made in adjustable or variable rate securities whose interest rates move in the same direction, and by the same amount, as standard short-term money market interest rate benchmarks, such as fed funds, LIBOR, Treasury bills, one-month commercial paper and the prime rate, and conform with other investment guidelines of the City, pool or fund. The values of these securities tend to return to par upon the scheduled adjustment of interest rates. Some parties in the financial services industry consider these types of adjustable rate securities to be derivatives; others do not.
 - (l) U.S. Treasury Separate Trading of Registered Interest and Principal Securities ("STRIPS") and other zero coupon treasury obligations are not considered derivatives and may be purchased to the extent not created by a third party. These instruments are subject to the same interest rate risks as U.S. Treasury securities of the same duration. STRIPS are fundamentally different from mortgage-backed and other interest-only or principal-only securities that are subject to unscheduled prepayments of principal.
- (2) All investments must be made in U.S. dollar-denominated securities.

- (3) The dollar-weighted average portfolio maturity (including interest rate reset periods) may not exceed one year; individual maturities may not exceed five years. Reserve funds may be invested in securities exceeding five years if the maturity of such investments coincides as nearly as practicable with the expected use of funds. Investments in securities with maturities in excess of five years should be separately identified and discussed in quarterly investment reports.

A U.S. government or agency security with a variable interest rate that resets no less frequently than annually shall be deemed to have a maturity equal to the period remaining until the next readjustment of the interest rate.

In calculating the dollar-weighted average maturity (WAM) of the overall portfolio, investments in custodial arrangements, pools or money market funds managed to maintain a constant net asset value (specified in Section VI E (d) to (f)), due to their high degree of liquidity, should be factored in as having one-day maturities.

Note: Investments in pools or funds with fluctuating net asset values - if allowed (see Section VI E (j)) - should be factored in based on the WAM of the individual fund.

- (4) The Finance Director shall diversify the City's investments to avoid incurring unreasonable risks inherent an over-concentration in specific instruments, individual issuers or maturities. Diversification strategies shall include:
- (a) At the time of acquisition, no more than ten percent (10%) of the overall portfolio may be invested in deposits with a single bank, unless the deposits are fully-insured or fully collateralized, or in repurchase arrangements for a period longer than two business days conducted through a single dealer.
 - (b) There is no limitation on the percentage of the overall portfolio that may be invested in: (1) U.S. government and agency obligations and in repurchase agreements fully collateralized by such securities, (2) STIF, (3) TEPF, or (4) an authorized custodial arrangement, pool of money market fund specified in Section VI E (d).
 - (c) At the time of acquisition, no more than twenty-five percent (25%) of the overall portfolio may be invested in floating rate securities with final maturities in excess of two years.
 - (d) Investments in securities that are not readily marketable, other than securities or deposits that mature within seven days, may not exceed ten percent (10%) of the portfolio's net assets at the time of purchase.

This section does not apply to bank accounts used for the temporary deposit of receipts and deposits needed to cover disbursements that are expected to clear over the next seven days,

Investment decisions shall be based on the relative and varying yields and risks of individual securities and the City's liquidity requirements.

VII. Investment Parameters

A. Diversification

The investments shall be diversified by:

- Limiting investments to avoid over-concentration in securities from a specific issuer or business sector (excluding U.S. Treasury securities);
- Limiting investment in securities that have higher credit risks;
- Investing in securities with varying maturities; and
- Continuously investing a portion of the portfolio in readily available funds such as the State of Connecticut Treasurer's Investment Fund (STIF), money market funds or overnight repurchase agreements to ensure that appropriate liquidity is maintained in order to meet ongoing obligations.

B. Maximum Maturities

To the extent possible, the City shall attempt to match its investments with anticipated cash flow requirements. Unless matched to a specific cash flow, the City will not directly invest in securities maturing more than one year from the date of purchase.

Reserve funds and other funds with longer-term investment horizons may be invested in securities exceeding one year if the maturity of such investments are made to coincide as nearly as practicable with the expected use of funds.

Because of inherent difficulties in accurately forecasting cash flow requirements, a portion of the portfolio should be continuously invested in readily available funds to ensure that appropriate liquidity is maintained to meet ongoing obligations.

VIII. Reporting

A. Methods

The Finance Director shall prepare an investment report, quarterly, including a management summary that provides an analysis of the status of the current investment portfolio and transactions made over the last quarter. This management summary will be prepared in a manner that will allow the City to ascertain whether investment activities during the reporting period have conformed to the investment

policy. The report should be provided to the Mayor and the Board of Aldermen. The report will include the following:

- Listing of individual securities held at the end of the reporting period.
- depreciation by listing the cost and market value of securities over one-year duration that are not intended to be held until maturity (in accordance with Governmental Accounting Standards Board (GASB) requirements).
- Average weighted yield to maturity of portfolio on investments as compared to applicable benchmarks.
- Listing of investment by maturity date.
- Percentage of the total portfolio which each type of investment represents.

B. Performance Standards

The investment portfolio will be managed in accordance with the parameters specified within this policy. The portfolio should obtain a market average rate of return during a market/economic environment of stable interest rates. A series of appropriate benchmarks shall be established against which portfolio performance shall be compared on a regular basis.

C. Marking to Market

The market value of the portfolio shall be calculated at least quarterly and a statement of the market value of the portfolio shall be issued at least quarterly. This would include the valuation of investment pools such as STIF.

IX. Policy Considerations

A. Exemption

Any investment currently held that does not meet the guidelines of this policy shall be exempted from the requirements of this policy. At maturity or liquidation, such monies shall be reinvested only as provided by this policy.

B. Amendments

This policy shall be reviewed on an annual basis. Any changes to this policy must be approved by the Mayor after consultation with the Finance Director, by resolution of the Board of Aldermen and the Treasurer, as well as the individual(s) charged with maintaining internal controls.

CITY OF WATERBURY

Investment Policy

Glossary of Investment Terms

Agency Securities - the securities issued by U.S. Government agencies, such as the Federal Home Loan Bank. These securities have high credit ratings but are not backed by the full faith and credit of the U.S. Government,

Benchmark - a standard unit used as the basis of comparison; a universal unit that is identified with sufficient detail so that other similar classifications can be compared as being above, below, or comparable to the benchmark.

Bid - the price offered by a buyer of securities. (When you are selling securities, you ask for a bid.) See Offer.

Book entry - a system of recording securities ownership through electronic accounts.

Broker - a broker brings buyers and sellers together for a commission.

Certificates of Deposit (CDs) - a debt instrument issued by banks usually paying interest with maturities ranging from. seven days to several years.

CMT (Constant Maturity Treasury) - a long-term interest rate benchmark index based on the yield of a synthetic security of appropriate maturity as interpolated from the Treasury yield curve.

COFI (Cost of Funds Index) - a lagging interest rate reference index based on the cost of funds to 11th District (United States) savings and loan associations.

Collateral - underlying securities that are pledged to secure deposits of public funds. Also used in conjunction with repurchase agreements to protect the entity from default by the counter party.

Current Yield - the relationship between the annual coupon interest rate and the market price of a fixed-income security. In calculating current yield, only the coupon interest payments are considered; no consideration is given to capital gain/ loss or interest on interest.

Custody - the service of an organization, usually a financial institution, of holding (and reporting) a customer's securities for safekeeping, The financial institution is known as the custodian.

Dealer - a dealer, as opposed to a broker, acts as a principal in all transactions, buying and selling for his or her own account.

Delivery versus Payment (DVP) - a settlement procedure where payment for a securities purchase is made simultaneously with the transfer of the purchased securities. The same procedure applies for a securities sale; the securities are transferred as payment is made.

Derivative - a security that derives its face value from an underlying asset, group of assets, reference rate, or an index value. Some derivative instruments can be highly volatile and result in a loss of principal in changing interest rate environments,

Discount Securities - non-interest bearing money market instruments that are issued at a discount and redeemed at maturity for full face value, e.g., U.S. Treasury Bills.

Discount - the amount by which a bond sells under its par (face) value.

Diversification - dividing investment funds among a variety of securities, offering independent returns, to reduce risk inherent in particular securities.

Federal Deposit Insurance Corporation (FDIC) - a federal agency that insures bank deposits - currently up to \$100,000 per depositor.

Interest-Only Securities (IOs) - the interest cash flow portion of a stripped mortgage-backed security or bond. The holder receives no principal payments. A significant loss in value can occur on IOs created from mortgage-backed securities when the underlying mortgage prepayments accelerate, typically in a falling interest-rate environment

Inverse Floater - A security that reacts inversely to the direction of interest rates. These securities can be very volatile and can lose value in a rising interest-rate environment.

Leverage - An attempt to increase the rate of return on an investment by buying securities on margin or using borrowed funds for investment purposes. This practice can be risky if interest rates rise or if investment yields are lower than expected.

LIBOR (London Inter-Bank Offered Rate) - The primary fixed income index referenced rates used in the Euromarkets. Most international floating rates are quoted as LIBOR plus or minus a spread.

Liquidity - a liquid asset is one that can be converted easily and rapidly, into cash without a substantial loss of value. In the money market, a security is said to be liquid if the spread between bid and asked prices is narrow and reasonable size can be done at those quotes.

Market Value - the price, at which buyers and sellers trade similar items in an open marketplace.

Master Repurchase Agreement - a written contract covering all future transactions between the parties to repurchase/reverse repurchase agreements that establishes each party's rights in the transactions. A master agreement will often specify, among other things, the right of the buyer-lender to liquidate the underlying securities in the event of default by the seller-borrower.

Maturity Date - the date on which the principal amount of a bond or other debt instrument becomes payable or due.

Money Market Fund - an open-ended mutual fund that invests in commercial paper, bankers acceptances, repurchase agreements, government securities, certificates of deposit, and other highly liquid and safe securities and pays money market rates of interest. The fund's net asset value remains a constant \$1/share - only the interest rate goes up or down.

Money Market - the market in which short-term debt instruments (bills, commercial paper, bankers acceptances, etc.) are issued and traded.

Net Asset Value (NAV) - the total assets minus liabilities, including any gains or losses on investments or currencies, and any accrued income or expense, used in account valuation-

Offer - the price asked by a seller of securities. (When you are buying securities, you ask for an offer.) See Asked and Bid.

Option - a contract between two parties, which gives one party the right, but not the obligation, to buy or sell an asset at a fixed price until a specific date. An option to purchase an asset is a *call*. An option to sell an asset is a *put*. Options can be very risky transactions and require an investor to make a judgment call on the timing of the transaction as well as the value of the underlying asset.

Par Value - The stated or face value of a bond. Specifies the payment amount at maturity.

Principal-Only Securities (POs) - the principal portion of a bond, such as a long-term Treasury bond or a pool of mortgage-backed securities, that have been stripped of interest payments. POs are generally long-term in nature.

Rate of Return - the amount of income received from an investment, expressed as a percentage. A market rate of return is the yield that an investor can expect to receive in the current interest-rate environment utilizing a buy-and-hold to maturity investment strategy.

Repurchase Agreements (Repos) - an agreement to purchase securities from an entity for a specified amount of cash and to resell the securities to the entity at an agreed upon price and time. Repos are widely used as a money market instrument.

Reverse Repurchase Agreements (Reverse Repos) - an agreement to sell securities to an entity in return for a specified amount of cash and repurchase the securities at an agreed upon price and time- A reverse repurchase agreement is the sell-side of the repurchase agreement transaction.

S&P Ratings:

AAA - the debt having the highest rating assigned by Standard & Poors. It has the highest capacity to pay interest and its ability to repay principal is extremely strong. Securities rated **AAA** are referred to as gilt-edged.

AA - this debt, which is the lowest rating assignable to investment grade securities, is regarded as having an adequate protection parameters, adverse economic conditions or changing circumstances are more likely to lead to weakened capacity to pay interest and repay principal for debt in this category than in higher rated categories.- The debt having a very strong capacity to pay interest and repay principal and differs from the higher rated issues only in small degree.

A - this debt has a strong capacity to pay interest and repay principal although it is somewhat more susceptible to the adverse effects of change in circumstances and economic conditions Than debt in higher rated categories.

BBB - this debt, which is the lowest rating assignable to investment grade securities, is regarded as having an adequate capacity to pay interest and repay principal. Although it normally exhibits

BB, B, CCC and CC - these ratings are regarded, on balance, as predominantly speculative with respect to capacity to pay interest and repay principal in accordance to the terms of the obligation.

C - this is reserved for income bonds on which no interest is being paid.

D - this rating is for debt that is in default. No interest or principal payments are being made.

Safekeeping - a procedure where securities are held by a third party acting as custodian for a fee.

Swap - the trading of one asset, or cash flows, for another. Sometimes used in active portfolio management to increase investment returns by swapping one type of security for another, Also, used to manage risk; for example, swapping fixed interest rate payments for floating rate payments.

Thomson Bank Watch - rating agency for banks, Thomsons ratings on short-term securities span from TBW-1 through TBW-4, Long-term instruments are rated A through E.

Total Return - interest income plus capital gains (or minus losses) on an investment.

Treasury Bill (T-Bill) - short-term, highly liquid government securities issued at a discount from the face value and returning the face amount at maturity.

Treasury Bond or Note - debt obligations of the federal government that make semiannual coupon payments and are sold at or near par value in denominations of \$1,000 or more.

Variable Rate Note - floating rate notes with a coupon rate adjusted at set intervals, such as daily, weekly or monthly based on different interest rate indices, such as LIBOR, Fed Funds, and Treasury Bills.

Yield - the rate of annual income return on an Investment expressed as a percentage. Income Yield is obtained by dividing the current dollar income by the current market price of the security. Net Yield or Yield to Maturity is the current income yield minus any premium above par or plus any discount from par in purchase price, with the adjustment spread over the period from the date of purchase to the date of maturity of the bond.